No. 80-1188

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In the Supreme Court of the United States

OCTOBER TERM, 1980

JAMES EDGAR, APPELLANT

v.

MITE CORPORATION AND MITE HOLDINGS, INC.

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the Illinois Business Take-Over Act is unconstitutional under the Supremacy and Commerce Clauses of the United States Constitution.

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ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

This is an action seeking injunctive relief and a declaration that the Illinois Business Take-Over Act (Ill. Ann. Stat. ch. 121 1/2, § 137.51 *et seq.* (Smith-Hurd Cum. Supp. 1980)) is unconstitutional under the Supremacy and Commerce Clauses of the United States Constitution. Appellees MITE Corporation and MITE Holdings, Inc. ("MITE") filed this action in the United States District Court for the Northern District of Illinois against the Secretary of State of Illinois, who is charged with the administration and enforcement of the Illinois statute. MITE Corporation and MITE Holdings, Inc., are Delaware corporations with their principal executive offices in New Haven, Connecticut (J.S. App. 2a).

MITE filed its complaint on the same day that it commenced a cash tender offer for the shares of Chicago Rivet and Machine Company ("Chicago Rivet") by complying with Section 14(d) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(d). Chicago Rivet is a publicly-held Illinois corporation with its principal executive offices in Bellwood, Illinois. Chicago Rivet's shares are traded on the American Stock Exchange and are held by a total of 2,181 shareholders of record, of whom 589 (27%) are residents of Illinois (J.S. App. 2a-3a).

The Illinois statute imposed certain preconditions, beyond those prescribed in the federal securities laws, to the commencement of MITE's tender offer. These included the filing of a notice of the proposed tender offer with state officials, completion of a 20-day waiting period, and—if the Illinois Secretary of State so ordered—an adjudication of the substantive fairness of MITE's offer. MITE declined to comply with these requirements and sought, in addition to declaratory relief, an injunction prohibiting the enforcement of the Illinois statute in connection with its tender offer. The district court entered a preliminary injunction enjoining the Secretary of State from issuing a cease and desist order or notice of hearing under the Illinois statute, or from otherwise enforcing the statute against MITE.[1]

In accordance with federal law, MITE then commenced its tender offer and published notice thereof in the national edition of the Wall Street Journal. The tender offer represented a proposed transaction in interstate commerce in excess of $23 million, and extended to all shareholders of

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[1]The Illinois Secretary of State previously had issued a Temporary Cease and Desist Order and Notice of Hearing after finding that the tender offer was within his jurisdiction and that the Illinois statute was about to be violated. He notified MITE of his intention to serve an order requiring MITE, among other things, to "cease and desist all further action to make a tender offer to security holders of the Chicago Rivet & Machine Co." (J.S. App. 36a).

Chicago Rivet residing throughout the United States (J.S. App. 5a). The tender offer price per share was $28. This represented a premium of more than $4 per share over the market price in the period immediately preceding the announcement of the offer (*id.* at 34a).

Following a hearing on MITE's motion for a permanent injunction, the district court entered a final judgment in favor of MITE (J.S. App. 32a-41a). The court declared the Illinois statute to be both preempted by the Williams Act amendments to the Securities Exchange Act of 1934[2] and an undue burden on interstate commerce. The district court therefore permanently enjoined enforcement of the Illinois statute against MITE (*id.* at 41a). The court of appeals affirmed (*id.* at 1a-31a). The court of appeals agreed that several provisions of the Illinois statute frustrated the congressional purposes underlying the Williams Act and therefore were preempted. The court also found that the Illinois statute substantially obstructed interstate commerce without being necessary to the achievement of any significant local objective, in contravention of the Commerce Clause.

ARGUMENT

The decision of the court of appeals correctly applies legal principles that this Court previously has enunciated. The United States therefore believes that the judgment below should be affirmed. Moreover, in view of the absence of any conflict among the courts of appeals and the clarity of the governing legal principles, the Court may wish to consider summary affirmance. Sup. Ct. R. 15.1(h).

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[2]The Williams Act added new Sections 13(d), 13(e), 14(d), 14(e) and 14(f) to the Securities Exchange Act of 1934. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454 (codified at 15 U.S.C. 78m(d)-(e) and 78n(d)-(f)).

1. The court of appeals' decision in this case is fully in accord with the only other decision of a court of appeals concerning the constitutionality of a state takeover statute as applied to a tender offer. See *Great Western United Corp.* v. *Kidwell*, 577 F. 2d 1256 (5th Cir. 1978), rev'd on venue grounds *sub nom. Leroy* v. *Great Western United Corp.*, 443 U.S. 173 (1979).[3] In that case, the Fifth Circuit declared unconstitutional, on both Supremacy and Commerce Clause grounds, the Idaho Corporate Takeover Law, which is similar in all relevant respects to the Illinois statute at issue in this appeal. The reasoning of the Seventh Circuit in this case is entirely consistent with that of the Fifth Circuit in *Kidwell*.

2. Recent changes in federal tender offer regulation have essentially eliminated the need for the lower courts to consider in the future one of the major issues decided by the court of appeals in this case—whether a state statute that requires public disclosure of the material terms of a tender offer, followed by a substantial waiting period before the tender offer may commence, frustrates a congressional purpose underlying the Williams Act. Pursuant to its rule-making authority under the Securities Exchange Act and the Williams Act, the Securities and Exchange Commission recently promulgated detailed rules governing the conduct of tender offers. See Securities Exchange Act Release No. 16384, 44 Fed. Reg. 70326 (1979). Rule 14d-2(b), 17 C.F.R. 240.14d-2(b), which defines the date of commencement of a

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[3] In *Kennecott Corp.* v. *Smith*, 637 F. 2d 181 (3d Cir. 1980), the Third Circuit endorsed the Seventh Circuit's reasoning in the present case and held that the district court abused its discretion by denying a preliminary injunction against the operation of a similar New Jersey takeover statute. The court found that "there is a reasonable likelihood that Kennecott will prevail in its contention that the Williams Act and the regulations preempt New Jersey's takeover rule." *Id.* at 191. On remand, the district court held that the Williams Act did in fact preempt the New Jersey statute. See note 6, *infra*.

cash tender offer, requires that a tender offeror, within five days of making a public announcement of the material terms of the offer, either begin its offer by disseminating specified information to security holders and filing the requisite documents with the Commission or announce that it is withdrawing its offer. As a validly promulgated federal regulation,[4] Rule 14d-2(b) constitutes federal law and preempts contrary state requirements (*Free* v. *Bland*, 369 U.S. 663, 668 & n.10 (1962)).

Rule 14d-2(b) stands in direct operational conflict with the provisions of state takeover laws such as the Illinois statute. The Illinois statute requires a public filing setting forth the material terms of the proposed tender offer and imposes a post-announcement waiting period prior to the effective date of the tender offer.[5] Such state requirements are in direct conflict with Rule 14d-2(b), since they forbid precisely what the federal rule requires—the prompt commencement of the tender offer once the offeror has publicly disclosed the material terms of its offer. Accordingly, federal and state courts uniformly have held that Rule 14d-2(b)

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[4]In *Canadian Pacific Enterprises (U.S.), Inc.* v. *Krouse*, [Current] Fed. Sec. L. Rep. (CCH) para. 97,863 (S.D. Ohio Jan. 13, 1981), appeal pending, No. 81-3083 (6th Cir., filed Feb. 17, 1981), the court held, in the face of a direct challenge, that Rule 14d-2(b) is a valid federal regulation.

[5]Ill. Ann. Stat. ch. 121 1/2, § 137.54.E (Smith-Hurd Cum. Supp. 1980) provides:

> A take-over offer shall become registered 20 business days after the date of filing the registration statement or an amendment thereto with the Secretary, unless accelerated by order or delayed by written notification, or unless prior thereto the Secretary calls a hearing with respect to the offer.

Ill. Ann. Stat. ch. 121 1/2, § 137.54.B (Smith-Hurd Cum. Supp. 1980) requires that a tender offeror publicly disclose the material terms of the offer on or prior to the date of filing of the registration statement.

preempts the pre-commencement filing requirements of state takeover statutes.[6]

Because the events at issue in this litigation occurred before the effective date of Rule 14d-2(b), the court of appeals did not base its decision on the new rule, although it correctly observed that Rule 14d-2(b) would "directly conflict" with the pre-commencement disclosure provisions of the Illinois statute (J.S. App. 23a-24a n.25). Instead, the court focused on the broader question " 'whether, under the circumstances of this particular case, [the pre-commencement disclosure provisions, as well as the other provisions of Illinois law at issue,] * * * stan[d] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[7] Following the effective date of Rule 14d-2(b), however, courts considering the application of state takeover statutes to tender offers have examined the direct and self-evident conflict that the Rule produces (see note 6, *supra*), rather than utilizing the more general analysis applied by the court of appeals in this case. Thus, a central issue presented in this case—the validity of a state public notice and pre-commencement waiting period requirement, examined in light of the terms and purposes of the

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[6]See *Kennecott Corp.* v. *Smith*, [Current] Fed. Sec. L. Rep. (CCH) para. 97,858 (D.N.J. Jan. 29, 1981) (New Jersey takeover statute); *Canadian Pacific Enterprises (U.S.), Inc.* v. *Krouse*, [Current] Fed. Sec. L. Rep. (CCH) para. 97,863 (S.D. Ohio Jan. 13, 1981), appeal pending, No. 81-3083 (6th Cir., filed Feb. 17, 1981) (Ohio takeover statute); *Hi-Shear Industries, Inc.* v. *Neiditz*, [Current] Fed. Sec. L. Rep. (CCH) para. 97,805 (D. Conn. Dec. 16, 1980) (Connecticut takeover statute); *Eure* v. *Grand Metropolitan Ltd.*, 80 CVS 1685 (N.C. Super. Ct. Apr. 18, 1980) (North Carolina takeover statute). See also *Sun Life Group, Inc.* v. *Standard Life Insurance Co. of Indiana*, [1980] Fed. Sec. L. Rep. (CCH) para. 97,314 (S.D. Ind. Mar. 12, 1980) (absent an interpretation of the Indiana takeover statute by the state that eliminated the direct conflict with Rule 14d-2(b), the federal rule would have preempted the Indiana statute).

[7]J.S. App. 9a, quoting *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941).

Williams Act and without reference to the Commission's implementing rules—will not likely arise again.[8]

3. In any event, even viewing this case apart from the Commission's new regulations, the court of appeals correctly held that the Illinois statute violates both the Supremacy and Commerce Clauses of the United States Constitution. The decision of the court below involves no more than the application of well-settled principles of constitutional law to the facts of this case. The legal principles relevant to the analysis of the Supremacy and Commerce Clause issues are discussed at length on pages 15-62 of the brief amicus curiae of the Securities and Exchange Commission in *Leroy* v. *Great Western United Corp.*, No. 78-759 (hereinafter "*Leroy* Amicus Br.").[9]

a. The Illinois statute violates the congressional policies underlying the Williams Act against pre-commencement notification, fairness review by governmental officials, and undue delay of tender offers. See *Leroy* Amicus Br. 37-62. In particular, the Illinois statute, contrary to Congress' determination, (a) empowers a state official to pass on the substantive fairness of a tender offer and to block it, despite full compliance with federal law, if, in the opinion of that state official, the offer is "inequitable"; (b) allows outside directors or a substantial security holder of the subject company to require that state hearings be held; (c) prevents the tender offer from proceeding until the state hearings

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[8]The Commission's rules do not apply to tender offers (such as the present tender offer) made prior to their effective date. J.S. App. 24a n.25. As discussed above, a federal court considering the preemption issue in the future and applying the Commission's rules as well as the Williams Act would have little choice, absent a harmonizing interpretation by the state, see note 6, *supra*, but to find a state statute (such as the Illinois statute) to be preempted.

[9]Copies of our brief amicus curiae in *Leroy* are being served on counsel to the parties herein.

have been completed; and (d) imposes a lengthy pre-notification requirement on tender offerors. See J.S. App. 22a. In light of these state-imposed impediments to federally regulated tender offers, the court of appeals correctly applied the principle that a state statute may not, consistent with the Supremacy Clause, frustrate the achievement of congressional objectives embodied in federal law. See *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile*, No. 79-1336 (Mar. 9, 1981), slip op. 5; *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941).

Under the Illinois statute, outside directors or a substantial security holder of a subject company—and, indirectly, incumbent management (see J.S. App. 14a-15a)—may demand a hearing and thereby prevent the tender offer from going forward until the hearing is concluded. See Ill. Ann. Stat. ch. 121 1/2, § 137.57.A (Smith-Hurd Cum. Supp. 1980). The statute provides no fixed date for the completion of this adjudicatory proceeding. *Id.* at § 137.57.C-D. Such an impediment to tender offers conflicts with "Congress' judgment that delay grossly in excess of that contemplated by the Williams Act redounds to the detriment of stockholders by substantially deterring the making of tender offers." J.S. App. 20a-21a; see also *Leroy* Amicus Br. 42-62. In addition, the Illinois statute provides that, once a hearing is commenced, the Secretary of State must adjudicate, not merely the adequacy of disclosure, but the substantive fairness of the tender offer.[10] He is required to deny registration

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[10]Appellant argues (J.S. 10) that the Illinois statute does not permit the Illinois Secretary of State to adjudicate the fairness or equitableness of a tender offer, contending that the "word 'inequitable' is coupled with 'fraud' and 'deceit' and simply does not put the Secretary in the position of looking at the amount of the offer." That, however, ignores the plain text of the statute, which directs the Secretary of State to deny registration to a tender offer on the ground that it "fails to provide full and fair disclosure to the offerees of all material information concerning the take-over offer, *or that the take-over offer is inequitable* or would work

to tender offers (even those at a premium above current market price) that are "inequitable." See Ill. Ann. Stat. ch. 121 1/2, § 137.57.E (Smith-Hurd Cum. Supp. 1980). As explained by the court of appeals, this contravenes a fundamental purpose of the Williams Act, which

> contemplates unfettered choice by well-informed investors. Both the House and Senate Reports observed that "[t]his bill is designed to make the relevant facts known so that shareholders have a fair opportunity to make *their* decision."

J.S. App. 12a, quoting H.R. Rep. No. 1711, 90th Cong., 2d Sess. 4 (1968), and S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967) (emphasis added by the court of appeals). Finally, the imposition of a lengthy pre-notification requirement under Ill. Ann. Stat. ch. 121 1/2, § 137.54.E—a requirement that Congress "has repeatedly rejected"[11]—impermissibly conflicts with the congressional purpose to allow tender offers to proceed on an expeditious basis without tipping the balance of advantage between the bidder and incumbent

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or tend to work a fraud or deceit upon the offerees * * *" (Ill. Ann. Stat. ch. 121 1/2, § 137.57.E (Smith-Hurd Cum. Supp. 1980) (emphasis added). The statute thus speaks in the disjunctive, making fraud, deceit, failure to disclose, and the inequitable character of the tender offer separate grounds for denial of registration. We note, in this connection, that appellant cites no state authority to support a contrary interpretation of the statute.

[11] J.S. App. 18a-19a. The court of appeals noted that Congress, on three separate occasions, has rejected proposals to impose pre-notification requirements. See *id.* at 19a n.23. In addition, two bills introduced in the 94th Congress would have amended the tender offer provisions of the Williams Act to require a 60-day pre-commencement filing with the Commission. S. 2522, 94th Cong., 1st Sess. § 3 (1975); H.R. 10650, 94th Cong., 1st Sess. § 3 (1975). A third bill would have required such a filing, and its transmission to the subject company, at least 21 days prior to commencement. H.R. 14317, 94th Cong., 2d Sess. § 5 (1976). None of these bills was reported out of committee.

management. See *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 58-59 (1975) ("Congress expressly disclaimed an intention to provide a weapon for management to discourage takeover bids * * *"); see also *Leroy* Amicus Br. 42-54.[12]

We do not, of course, contend that the federal government has occupied the entire field of securities regulation or that the states have no role to play. Congress has approved concurrent regulation of some types of securities transactions by state governments. Congress has forbidden, however, attempts by the states to regulate securities transactions in a manner that would undermine or conflict with the operation of federal law. See Section 28(a) of the Securities Exchange Act, 15 U.S.C. 78bb(a), which bars any state from enacting a law that conflicts with either the Securities Exchange Act or any rules or regulations issued by the Commission thereunder.[13] Thus, the Illinois statute is not invalid simply because it regulates tender offers, but rather

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[12]Unlike the Illinois statute, which delays the commencement of a tender offer until the bidder has complied with the statute's pre-commencement filing and review provisions, the Hart-Scott-Rodino Antitrust Improvements Act, 15 U.S.C. 18a, does not delay commencement but merely precludes a bidder from purchasing tendered shares until it has received clearance from the Federal Trade Commission and the Department of Justice. 15 U.S.C. 18a(a). Moreover, the Hart-Scott-Rodino Act does not require, as does the Illinois statute, that a bidder make a public announcement of the material terms of its offer in the pre-commencement period. To the contrary, the Act provides for confidential treatment of the bidder's filing. 15 U.S.C. 18a(h).

[13]Section 28(a) provides in part:

> Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

Section 28(a) "was designed to save state blue-sky laws from preemption" (*Leroy* v. *Great Western United Corp.*, *supra*, 443 U.S. at 182 n.13), but only insofar as such laws do not conflict with federal statutes and regulations.

because it regulates them in a way that conflicts with the Williams Act and frustrates the accomplishment of its objectives.

b. The court of appeals also correctly concluded (J.S. App. 24a-30a) that the Illinois takeover statute contravenes the Commerce Clause. See *Leroy* Amicus Br. 15-36. In reaching that conclusion, the court applied the familiar test set forth by this Court in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970). *Pike* establishes that a state statute is invalid under the Commerce Clause if the burden that it imposes on interstate commerce outweighs the putative local benefits that it confers. See also *Kassel* v. *Consolidated Freightways Corp.*, No. 79-1320 (Mar. 24, 1981), slip op. 7, 14-15; *id.* at 1-2 (Brennan, J., concurring). After a careful examination of the claimed benefits of the Illinois statute, the court of appeals found that those benefits were in large measure speculative and were clearly outweighed by the obstructive effect of the statute on transactions in interstate commerce. The court observed (J.S. App. 25a-26a), with respect to Illinois' asserted interest in protecting resident securities holders, that the Williams Act already accorded shareholders the disclosure and substantive protections sought to be achieved by the Illinois statute. Consequently, the Illinois statute provided only a "marginal increase" in time and information available to Illinois shareholders (*ibid.*):

> Protecting resident investors is indisputably a legitimate state objective. Yet, as set forth above, the Williams Act itself protects investors by requiring disclosure, withdrawal rights, pro rata purchases and equal consideration for all shares taken up. Therefore, the benefit of the Illinois Act is limited to the marginal increase in information, time and other benefits that Illinois shareholders may gain as a result of the Act's operation. But, as we noted in the context of preemp-

> tion, the potentially prolonged delay required by the Act may, in some circumstances at least, be detrimental to the interests of shareholders. * * * Thus, the benefits flowing to Illinois shareholders from the Act are, to a significant degree, speculative.

The court of appeals also correctly rejected the assertion that interference with nationwide tender offers through local legislation was justifiable on a theory that the state was simply "regulating the internal affairs of a corporation incorporated under Illinois law" (J.S. App. 26a). See also *Leroy* Amicus Br. 28-31. The Illinois statute, on its face, regulates the relationship between shareholders and bidders, not the internal governance of the subject corporation. Moreover, the statute does not limit its coverage to companies incorporated under Illinois law. As the court of appeals explained (J.S. App. 28a), "the Act applies to corporations that are incorporated in another state and have their principal place of business outside of Illinois." Finally, Illinois need not enact statutes impeding tender offers to deal with internal corporate mismanagement such as "looting" or waste of assets (*id.* at 27a). Such mismanagement would be a breach of fiduciary duty subject to redress under traditional legal principles.

Having examined the benefits purportedly flowing from the Illinois statute, the court of appeals weighed those benefits against the statute's obstructive effect on interstate commerce. The court correctly found (J.S. App. 28a-29a) that the statute's negative impact on commerce outweighed the putative local benefits:

> The Act's most obvious burdens result from its global impact. Once the Act has been invoked, all purchases, or offers to purchase by the offeror, of the target company's stock pursuant to a tender offer may be halted, including transactions to be executed entirely outside

> the boundaries of Illinois. The Illinois Act thus possesses a significant potential to cause commercial disruption. For example, had the Secretary of State not been enjoined from going forward in the instant case, over 23 million dollars of interstate commerce would presumably have been affected. * * *
>
> We think that Illinois' tenuous interest in protecting resident shareholders and regulating control transfers cannot constitutionally justify the Illinois Act's burdensome impact on free-flowing commerce.

The court of appeals' analysis is consistent with the decisions of this Court. See *Kassel* v. *Consolidated Freightways Corp., supra;* see also *Leroy* Amicus Br. 31-36.[14]

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[14]Appellees argue that this appeal should be dismissed as moot. Motion to Dismiss or Affirm at 3-5. The court of appeals considered the issue of mootness and determined that, in view of MITE's potential criminal and civil liability for making a tender offer in violation of the Illinois statute (see Ann. Rev. Stat. ch. 121 1/2, §§ 137.63-137.65 (Smith-Hurd Cum. Supp. 1980)), the case was not moot (J.S. App. 6a).

Before the court of appeals, appellant took the position that appellees were subject to potential criminal or civil enforcement proceedings based on their violation of the Illinois statute. See J.S. App. 6a. The State has not, in this Court, disavowed an intent to institute such proceedings, in the absence of a definitive holding that its statute is unconstitutional. Thus, in view of "the flexible character of the Art. III mootness doctrine" (*United States Parole Comm'n* v. *Geraghty*, 445 U.S. 388, 400 (1980)), the realistic possibility of enforcement proceedings based on appellees' past conduct may be sufficient to avoid mootness in this case. See generally, *Bethlehem Steel Corp.* v. *Train*, 544 F. 2d 657, 660 (3d Cir. 1976), cert. denied, 430 U.S. 975 (1977).

We note, however, that if the Court were to agree with appellees that this case is moot, the proper disposition would be not to dismiss the appeal but to vacate the judgment below and to remand with a direction to dismiss the complaint as moot. See *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39 (1950).

CONCLUSION

Probable jurisdiction should be noted, and the judgment of the court of appeals should be affirmed.[15]

Respectfully submitted.

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[15]Because the court of appeals' decision correctly applies settled legal principles, and because the issues posed by appellant have not engendered disagreement among the courts of appeals, it is doubtful whether "the questions presented are so substantial as to require plenary consideration, with briefs on the merits and oral argument, for their resolution." Sup. Ct. R. 15.1(h). The Court therefore may wish to consider summary affirmance.

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